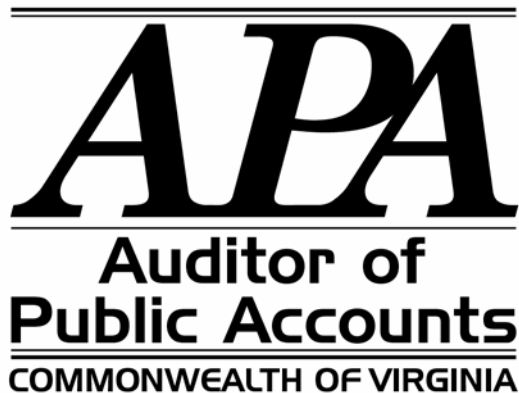


DEPARTMENT OF MINORITY BUSINESS ENTERPRISE

**REPORT ON AUDIT
FOR THE PERIOD FEBRUARY 1, 2006
THROUGH JANUARY 31, 2007**



AUDIT SUMMARY

Our audit of the Department of Minority Business Enterprise for the period February 1, 2006, through January 31, 2007, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System and
- matters involving compliance and internal control and its operation that we have communicated to management in the Comments to Management section of this report.

Risk Alert and Efficiency Issue:

During the course of our audits, we encounter issues that are beyond the corrective action of management and require the action of either another agency, outside party, or the method by which the Commonwealth conducts its operations. We feel that these practices or conditions represent a risk to the Commonwealth.

We review the agreements between smaller agencies, which do not have sufficient resources or staff, and their use of larger agencies for accounting, budgeting, personnel, or information security resources. We have found circumstances where these arrangements are not providing or improving internal controls. In some circumstances, we have found that the arrangement may contribute to actually weakening internal controls. The Secretaries of Administration, Finance, and Technology should work with the Departments of Accounts, General Services, Planning and Budget, and Human Resource Management, and the Virginia Information Technologies Agency to develop and implement an administrative agreement for all back office operations. This agreement should include outside managerial oversight and internal controls for agencies requiring administrative assistance or the Secretaries should establish a back office operation to provide these functions. We discuss this recommendation in greater detail within the section entitled, "Comments to Management".

Update on Prior Year Recommendations

The Department of Minority Business Enterprise (Department) has made progress in improving its operations and management has taken a number of actions to address the internal control issues, however, the current structure within which management operates and limited resources restricts their ability to fully resolve the matters raised. We therefore continue to find many of the same problems with internal control and compliance during fiscal year 2006 that we discussed in prior reports.

We did not repeat each of the findings included in the two previous fiscal year reports because, as of October 2006, the Department of General Services (General Services) assumed responsibility for the fiscal functions of the Department. Although we have noted some improvements in the Department's fiscal operations since General Services took on these responsibilities, internal control weaknesses continue to exist. We recommend, as stated above, that the Department work with General Services as well as other service-providing agencies to establish arrangements that outsource the entire fiscal function, rather than simply outsourcing transaction processing.

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COMMENTS TO MANAGEMENT

Risk Alert and Efficiency Issue

During the course of our audits, we encounter issues that are beyond the corrective action of only management and also require the action of either another agency, outside party, or the method by which the Commonwealth conducts its operations. We feel that these practices or conditions represent a risk to the Commonwealth.

Improve Service Arrangements Between Agencies

The Auditor of Public Accounts has advocated that smaller agencies, which do not have the resources or staff, use larger agencies for business functions, such as accounting, budgeting, information security or personnel resources. These arrangements allow the smaller agencies to concentrate on providing program services and eliminate unnecessary personnel costs and resources dedicated to administrative functions.

During an audit, we review the arrangements between agencies and the internal controls surrounding financial transactions, payroll, fringe benefits, and information security. We have found circumstances where these arrangements are not providing or improving internal controls. In some circumstances, we have found that the arrangement may contribute to actually weakening internal controls.

Smaller agencies do not have the staff expertise or resources to process financial transactions, personnel and payroll, procurement, and other administrative processes, such as implementing an adequate information security program, and maintain adequate separation of functions for basic internal controls. Loss of one person can, and does in many of these agencies, compromise the internal control structure and knowledge base needed to handle key transactions and duties. Therefore, the use of larger agencies with sufficient staff and resources provides needed internal controls and management oversight of public resources.

Further, change in agency leadership may result in having leaders without knowledge of state processes, standards, regulations, and laws. Agency leadership without an understanding of this essential information could enter into agreements or contracts that are not in the best interest of the agency or the Commonwealth.

In many cases, the service arrangements are ad hoc agreements to provide services where neither the service provider nor the agencies have a clear understanding of what they need. The intended purpose of these arrangements is to provide expertise, oversight, and direction, where small agency management may neither possess nor understand the importance of internal controls or have the necessary financial management expertise.

Our audits have indicated that in some circumstances these service arrangements are providing no oversight or internal controls for the smaller agency. The service providers are simply processing the paperwork without any managerial review of the transactions. This situation does not improve the Commonwealth's or the smaller agencies' handling of state funds and compliance with applicable state policies and procedures.

In addition, our review of information security in the Commonwealth revealed that most small agencies do not have the resources, expertise, or funding to develop and implement adequate information security programs that protect their critical and sensitive data.

We believe that the Secretaries of Administration, Finance, and Technology should work with the Departments of Accounts, General Services, Planning and Budget, and Human Resource Management, and the Virginia Information Technologies Agency (VITA) to develop and implement an administrative agreement for all back office operations, including information security, managerial oversight and internal controls, for agencies requiring administrative assistance or establish a central back office operation to provide these functions. The current arrangements do not provide a cohesive process which addresses the true operations of an administrative unit. For example, purchasing depends on budget availability, understanding of state contracting practices, contract management, and ultimately the payment and recording of the purchase.

We believe that Secretaries need to address the needs of smaller agencies as an arrangement of outsourcing the entire administrative function rather than the paper processing of groups of transactions. We believe that this approach will improve the operational efficiency of these agencies. However, we do not believe that the Commonwealth will recognize any saving in either personnel or cost, since the smaller agencies are using marginal resources with marginal results.

We also recognize that leaders of the smaller agencies will resist this type of change, however, the Commonwealth will greatly improve its internal controls and gain risk management benefits.

Internal Control Findings and Recommendations

Update on Prior Year Recommendations

The Department of Minority Business Enterprise has made progress in improving its operations and management has taken a number of actions to address the internal control issues previously reported, however, the current structure within which management operates and limited resources restricts their ability to fully resolve the matters raised. As noted above, we believe that this agency and others having limited funding and other administrative resources can not achieve resolution of their internal control findings without resolution of the previously discussed issue.

We therefore continue to find many of the same problems with internal control and compliance that we discussed in prior reports. Internal control is a framework designed to provide reasonable assurance over the reliability of financial resources, effectiveness, and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations.

As of October 2006, General Services assumed responsibility for the fiscal functions of the Department. Although we have noted some improvements in the Department's fiscal operations since General Services took on these responsibilities, internal control weaknesses outlined in previous reports continue to exist. The Department must work with General Services as well as other service agencies, as discussed in the "Risk Alert and Efficiency Issue" section above, to establish arrangements that outsource the entire fiscal function, rather than simply outsourcing transaction processing.

The Department's Director has responsibility for understanding and ensuring the agency's systems, processes, and procedures are sufficient to provide the Department with adequate internal controls. However, the Department, similar to many smaller agencies, does not have resources to provide an appropriate level of administrative assistance; and therefore they out-source their fiscal functions to service providing agencies as necessary. Under this arrangement, the Department shares the responsibility with the service agencies to ensure that adequate oversight and controls over financial transactions exist.

In addition, the Department should consider transferring additional responsibilities to service agencies, including the review of cell phones and information technology security responsibilities as discussed below. This would allow the Department to concentrate more on their primary functions rather than administrative issues.

We continue to recommend that the Department follow and enforce its policies and procedures concerning the use of cell phones by its employees. The Department continues to struggle with internal controls relating to excessive use and cell phone monitoring and review. Additionally, we recommend that the Department continue to work with the Department of Transportation (Transportation) to determine the appropriate use of \$294,219 in funding transferred in fiscal year 2005 by the Department from the Highway Maintenance and Operating Fund to a special revenue fund. The Department received the funding from Transportation to support a portion of its activities to certify and assist minority contractors doing business with Transportation. This amount remains in the special revenue fund as of January 31, 2007. Our initial recommendation directed the Department and Transportation to update their internal agreement to address funding and appropriate activities. This agreement no longer exists because as of fiscal year 2007 the budget directly appropriates the funds to the Department. However, the Department still needs to resolve with Transportation the appropriate use of the funds remaining from the previous agreement.

Document Information Security Program

The Director has responsibility for the security and safeguarding of all databases, information, and information technology assets. Currently, the Department does not have a documented information security program that meets Virginia's Information Technology security standard, ITRM Standard SEC 2001.01.1 or SEC501-01 (effective July 1, 2006). Without a documented information security program, the Department cannot identify or adequately maintain critical information technology components, including data and applications, which the Department relies upon to carry out its business objectives.

Over the past three years, the Commonwealth has moved the information technology infrastructure supporting databases and information to VITA. VITA currently houses the database used by the Department for its primary operations. As the data owner of information stored on VITA servers, the Department needs to establish adequate information security policies and procedures for their data and applications. In addition, the Department should ensure that VITA can provide adequate security policies and procedures for their information technology infrastructure that minimize the risk of unauthorized disclosure or alteration of critical and/or sensitive data. Based on the Department's business objectives and the data in their ownership, the Department needs to at a minimum establish a formal Information Security Officer, complete and submit the VITA security audit plans and templates, develop the information technology portion of the Continuity of Operations Plan, and document system access policies and procedures.

The Department does not currently have the information technology expertise to maintain its own information security program. The Department should work with VITA, as discussed in the "Risk Alert and Efficiency Issue" section above, to establish an agreement which would require VITA to assist the Department with updating its information security policies and procedures to ensure they meet the current security standards and best practices. This would allow the Department to concentrate more on their primary functions rather than administrative issues.

AGENCY HIGHLIGHTS

The Department of Minority Business Enterprise assists in the establishment and promotion of small, women, and minority-owned (SWAM) businesses throughout the Commonwealth. A SWAM business is an enterprise that has one or more socially and economically-disadvantaged persons as either the owner or individuals with controlling interest. The Department offers several areas of support, including management and technical assistance, as well as educational, training, marketing, and outreach programs.

The Department's primary sources of funding are General Fund and Highway Maintenance and Operating Fund appropriations. During fiscal year 2006, the Virginia Department of Transportation transferred the Highway Maintenance and Operating Funds to the Department. The funds provided by Transportation support efforts to increase the participation of disadvantaged owned business enterprises in Virginia's federal transportation and construction industries. As of fiscal year 2007, the Department received a direct appropriation of these funds.

During fiscal year 2006, the Department's original budget increased primarily as a result of the Commonwealth Transportation funds transfer of over \$1 million as required by the 2005 Virginia Acts of Assembly, Chapter 951. The schedules below summarize the Department's budgeted revenues and expenses compared with actual results for fiscal year 2006.

Analysis of Budget and Actual Appropriations and Funding For Fiscal Year Ended June 30, 2006

Funding source:	<u>Original Budget</u>	<u>Adjusted Budget</u>	<u>Funding Received</u>
General Fund	\$463,163	\$1,100,383	\$1,100,383
Special Revenue Fund	-	43,000	43,000
Highway Maintenance and Operating Fund	<u>-</u>	<u>1,361,388</u>	<u>1,187,089</u>
Total Resources	<u>\$463,163</u>	<u>\$2,504,771</u>	<u>\$2,330,472</u>

Analysis of Budgeted and Actual Expenses For Fiscal Year Ended June 30, 2006

Minority Enterprise Industrial Development Services Program

<u>Program Expenses</u>			<u>Breakdown of Expenses by Funding Source</u>		
<u>Original Budget</u>	<u>Adjusted Budget</u>	<u>Actual</u>	<u>General Fund</u>	<u>Special Revenue Fund</u>	<u>Highway Maintenance and Operating Fund</u>
<u>\$463,163</u>	<u>\$2,504,771</u>	<u>\$2,016,564</u>	<u>\$792,657</u>	<u>\$43,000</u>	<u>\$1,180,907</u>

The Department transferred responsibility of internal fiscal functions from the Department of Housing and Community Development to the Department of General Services in October 2006 and human resource functions to the Department of Human Resource Management in January 2007. As in the previous year, the Department did not fill vacant positions, which contributed to the variance between budgeted and actual expenses.

The Department's payroll expenses of \$1,570,786 accounts for over 77 percent of total expenses. The Office employs approximately 20 full-time employees. The schedule below summarized the Department's expenses by program and type for fiscal year 2006.

Analysis of Expenses by Type
For Fiscal Year Ended June 30, 2006

Minority Enterprise Industrial Development Services Program

Expense type:	
Personal services	\$1,570,786
Contractual services	271,472
Supplies and materials	29,037
Transfer payments	29,419
Rent, insurance, and utilities	84,210
Equipment	<u>31,640</u>
Total expenses	<u>\$2,016,564</u>



Commonwealth of Virginia

Walter J. Kucharski, Auditor

**Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218**

April 24, 2007

The Honorable Timothy M. Kaine
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable Thomas K. Norment, Jr.
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

We have audited the financial records and operations of the **Department of Minority Business Enterprise** for the period February 1, 2006, through January 31, 2007. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

AUDIT OBJECTIVES

Our audit's primary objectives were to evaluate the accuracy of recorded financial transactions on the Commonwealth Accounting and Reporting System, review the adequacy of the Department's internal controls, test compliance with applicable laws and regulations, and review corrective actions of audit findings from prior year reports.

AUDIT SCOPE AND METHODOLOGY

The Department's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

- Expenditures
- Payroll expenditures
- Appropriations
- Transfers payments
- Application access

We performed audit tests to determine whether the Department's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and agreements, and observation of the Agency's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

CONCLUSIONS

We found that the Department properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The Department records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System.

We noted certain matters involving internal control and its operation and compliance with applicable laws and regulations that require management's attention and corrective action. These matters are described in the section entitled "Internal Control Findings and Recommendations."

The Department has not completed corrective action with respect to the previously reported findings "Consolidate Fiscal and Procurement Operations with Another Agency", "Transfer Funds to the Highway Maintenance and Operating Fund", and "Improve Controls over Cell Phone Usage". Accordingly, we have provided an update on the Department's progress in addressing these findings in the section entitled "Internal Control Findings and Recommendations". The Department has taken adequate action with respect to the audit finding reported in the prior year not repeated in this report.

EXIT CONFERENCE AND REPORT DISTRIBUTION

We discussed this report with management on May 17, 2007. Management's response has been included at the end of this report.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

SAH/sks



COMMONWEALTH of VIRGINIA

Office of the Governor

Viola O. Baskerville
Secretary of Administration

May 23, 2007

Mr. Walter J. Kucharski, Auditor
Auditor of Public Accounts
P. O. Box 1295
Richmond, Virginia 23218

Dear Mr. Kucharski:

I have and thank you for the May 14, 2007, letter about your concerns with some agency internal controls situations where smaller agencies agree with larger ones for some of their business functions. The recommendations you make will start being promptly addressed by this office when I meet with my colleagues in the Secretariats of Finance and Technology. Our staffs are working on this meeting as this letter reaches you. This meeting will include the other offices you recommend.

Again, I thank you for bringing these matters to my attention.

Very truly yours,

A handwritten signature in cursive script that reads "Viola O. Baskerville".

Viola O. Baskerville

Cc: William H. Leighty, Chief of Staff
Aneesh P. Chopra, Secretary of Technology
Jody M. Wagner, Secretary of Finance



Timothy M. Kaine
Governor

COMMONWEALTH of VIRGINIA

Stacy L. Burrs
Director

Department of Minority Business Enterprise

Viola O. Baskerville
Secretary of Administration

1111 East Main Street, Suite 300
Richmond, Virginia 23219

April 30, 2007

The Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

Dear Sir:

In my capacity as Director of the Department of Minority Business Enterprise (hereinafter, "DMBE" or the "Agency"), I have reviewed the findings and recommendations provided by the Auditor of Public Accounts in this report. I acknowledge the findings and recommendations included in the audit review for the period of February 1, 2006 through January 31, 2007.

The Agency is pleased to report that many operational and internal controls improvements and changes have been implemented since the fiscal year 2006 audit. However, as noted in this Audit, four findings require additional work. The Audit takes the time to state that DMBE and other small agencies are challenged by the structure and implementation of Agency Service Agreements and recommends a solution at the Secretarial level.

The Audit found two things: (1) that the Agency properly recorded and reported its transactions through the Commonwealth Accounting and Reporting System, and, (2) that matters involving compliance and internal control needed to be addressed. The Agency will continue to work with the Secretary of Administration and other agencies and Secretariats to develop and implement administrative solutions to improve on operational and internal controls

The Department of Minority Business Enterprise is fully committed to doing its part in addressing the recommendations included in this report. We appreciate the work of the APA in helping identify areas in which the Agency can be more efficient and secure.

Sincerely,

A handwritten signature in blue ink, appearing to be "S. Burrs".

Stacy L. Burrs, Director

DEPARTMENT OF MINORITY BUSINESS ENTERPRISE

DEPARTMENT OFFICIAL

Stacy Burrs
Director